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Supreme Court, U.S.
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No. 96-1883

In the Supreme Court of the United States

OCTOBER TERM, 1996

H. THOMAS FEHN, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Fifth Amendment privilege against compelled self-incrimination permits a corporation to make materially misleading statements in reports required to be filed with the Securities and Exchange Commission, on the ground that the truthful disclosure of omitted information would incriminate the corporation's controlling person.

2. Whether, in light of this Court's decision in *Central Bank of Denver* v. *First Interstate Bank of Denver*, 511 U.S. 164 (1994), and Section 20(f) of the Securities Exchange Act, 15 U.S.C. 78t(f), which was added to the Act while this case was pending on appeal, the Commission could maintain this injunctive action against petitioner for aiding and abetting violations of the securities laws.

3. Whether the court of appeals deprived petitioner of due process by concluding that Section 20(f) of the Securities Exchange Act authorizes this injunctive action without ordering supplemental briefing or oral argument directed to that issue.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-44a) is reported at 97 F.3d 1276. The opinion of the district court (Pet. App. 1c-27c) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on October 9, 1996. A petition for rehearing was denied on February 21, 1997. Pet. App. 1b. The petition for a writ of certiorari was filed on May 22, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a California attorney who, in 1987, represented the underwriter of an initial public

offering (IPO) of stock in CTI Technical, Inc. CTI was a Nevada corporation controlled by Edwin Wheeler, who also served as company president and chief executive officer. Pet. App. 8a-10a.

Shortly after the IPO, the Securities and Exchange Commission initiated an investigation, which ultimately revealed that the CTI offering had been fraught with federal and state securities law violations, and that the company's president, Edwin Wheeler, and others had engaged in a scheme to defraud investors by manipulating the price of the securities in "after-market" trading after the close of the offering. [1] Petitioner, who was not alleged to have participated in the violations arising out of the IPO, was retained to represent CTI, Wheeler, and others in connection with the Commission's investigation. Pet. App. 9a.

In the course of the Commission's investigation, petitioner learned that CTI had failed to file the quarterly reports on Form 10-Q that public companies are required to file with the Commission under Section 15(d) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78*o*(d), and implementing regulations, 17 C.F.R. 240.15d-13 (Rule 15d-13). Petitioner counseled Wheeler that CTI was required to file quarterly reports; he then reviewed and edited drafts of quarterly reports on behalf of CTI, and had

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[1] On September 18, 1989, CTI and Wheeler consented to a permanent injunction in a civil enforcement action brought by the Commission. Wheeler was subsequently convicted of securities fraud for false and misleading statements and omissions in the registration statement CTI had filed with the Commission in connection with its offering. See *United States* v. *Wheeler*, 29 F.3d 637 (9th Cir. 1994) (Table) (affirming conviction).

the final versions of three quarterly reports filed with the Commission. Pet. App. 10a-11a.

Petitioner knew that the quarterly reports were false and misleading in two regards. First, the reports gave a history of CTI that described Wheeler as a former consultant to the company who had only recently joined CTI. Petitioner knew, however, that Wheeler had promoted and controlled the company from its inception, and that the nominal directors of CTI were figureheads. Pet. App. 42a, 8c. Second, the quarterly reports described the company's financial position without disclosing material contingent liabilities arising from potential litigation in connection with its IPO. Petitioner knew, however, that CTI had significant litigation exposure from the federal and state securities law violations uncovered in the Commission's investigation of the IPO, and that the contingent liabilities presented by such potential litigation were material to the company's financial condition. *Id.* at 11a, 32a, 42a.

2. The Commission, alleging that petitioner had aided and abetted violations of Sections 10(b) and 15(d) of the Exchange Act (15 U.S.C. 78j(b), 78*o*(d)), as well as SEC Rules 10b-5, 12b-20, and 15d-13 (17 C.F.R. 240.10b-5, 240.12b-20, 240.15d-13), by assisting in the filing of the materially false and misleading quarterly reports by CTI, brought this injunctive action against petitioner. The Commission sought an order enjoining petitioner from violating the securities laws in the future. The district court agreed that petitioner had aided and abetted the CTI violations. It concluded that the false and misleading quarterly reports established the underlying violations, that petitioner knew that those reports were false and misleading and that he was contributing to CTI's

violations, and that petitioner rendered substantial assistance in the preparation and filing of the false reports. Pet. App. 17c-19c. The court concluded that an injunction was warranted because of the reasonable likelihood of future violations by petitioner. *Id.* at 25c.

3. On April 19, 1994, after issuance of the district court's injunction, this Court decided *Central Bank of Denver* v. *First Interstate Bank of Denver*, 511 U.S. 164. *Central Bank* held that there is no implied private right of action for damages against those who aid and abet violations of Section 10(b) of the Exchange Act but who do not themselves violate Section 10(b). The majority opinion in *Central Bank* did not address whether its ruling also precluded enforcement actions by the Commission against those who aid and abet violations of Section 10(b), although the dissenting opinion suggested that the logic of the majority opinion did preclude such enforcement actions. See 511 U.S. at 200 (Stevens, J., dissenting).

Petitioner appealed to the United States Court of Appeals for the Ninth Circuit, arguing that *Central Bank* precluded the Commission's action against him. Petitioner also contended that the district court had erred in finding that he aided and abetted CTI's securities law violations, and that the Fifth Amendment privilege against self-incrimination precluded liability based on CTI's failure to disclose its past violations in its quarterly reports.

4. On December 22, 1995, after oral argument before the court of appeals but before the issuance of its decision in this case, Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737. Section 104 of the PSLRA, entitled "Authority of Com-

mission to prosecute aiding and abetting" and codified as a new Section 20(f) of the Exchange Act, 15 U.S.C. 78t(f), provides that, for purposes of Commission injunctive actions brought under Section 21(d)(1) of the Exchange Act, 15 U.S.C. 78u(d)(1), "any person that knowingly provides substantial assistance to another person in violation" of the Exchange Act "shall be deemed to be in violation * * * to the same extent as the person to whom such assistance is provided." Section 21(d)(1) authorizes the Commission to seek an injunction from the district court "[w]henever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this chapter." 15 U.S.C. 78u(d)(1).

5. On October 9, 1996, the court of appeals affirmed the district court's injunction against petitioner. The court of appeals did not reach the question whether the Commission's action against petitioner based on his having aided and abetted CTI's securities law violations was precluded by the reasoning of *Central Bank*. The court held instead that the injunctive action was authorized by the new Section 20(f) of the Exchange Act, enacted in Section 104 of the PSLRA, which "appears to prevent lower federal courts from extending the logic of *Central Bank* to SEC injunctive actions." Pet. App. 13a.

The court of appeals first noted that, "[b]y its clear terms, Section 104 provides that aiding and abetting a violation * * * is itself a violation, and as such is subject to injunctive actions and civil actions for money penalties by the SEC." Pet. App. 14a. It then concluded that the new Section 20(f) applies to this case, after employing the retroactivity analysis of *Landgraf* v. *USI Film Products*, 511 U.S. 244 (1994).

Although the court noted that Congress had not expressly prescribed that Section 20(f) was to be applied to pending cases (Pet. App. 20a), it found that application of Section 20(f) to this case would not be retroactive, because the new provision "does not 'attach new legal consequences' to the events underlying the SEC's injunction of [petitioner]," but simply restored the legal regime to its status at the time that the district court had entered its judgment. *Id.* at 22a. The court also concluded that Section 20(f) falls within a well recognized exception to the presumption against retroactivity, for it "authorizes or affects the propriety of prospective relief." *Id.* at 24a (quoting *Landgraf*, 511 U.S. at 273).

The court also rejected petitioner's Fifth Amendment claim. Pet. App. 33a-38a. Following *California* v. *Byers*, 402 U.S. 424 (1971), and *Baltimore City Department of Social Services* v. *Bouknight*, 493 U.S. 549 (1990), the court considered whether the requirement of disclosure in the quarterly reports "targets a highly selective group inherently suspect of criminal activities, rather than the public generally," or involves "an area permeated with criminal statutes, rather than an essentially noncriminal and regulatory area of inquiry," and whether compliance "would surely prove a significant link in a chain of evidence tending to establish guilt * * * rather than disclosing no inherently illegal activity." Pet. App. 34a-35a (internal quotation marks and brackets omitted). In accord with the Second Circuit's decision in *United States* v. *Stirling*, 571 F.2d 708, cert. denied, 439 U.S. 824 (1978), the court concluded that the quarterly-report disclosure requirements do not implicate any of those concerns. The court observed that the Exchange Act and its regulations are essen-

tially regulatory and noncriminal, that those provisions are aimed at commercial entities generally and not specifically at a "highly selective," "inherently suspect" group, and that the underlying regulated activity (the sale of stock) is "inherently lawful" as a general matter. Pet. App. 37a-38a.

ARGUMENT

The court of appeals correctly concluded that the Exchange Act's disclosure requirements applicable to CTI's quarterly reports did not implicate the Fifth Amendment privilege against compelled self-incrimination, and that petitioner therefore could be held responsible as an aider and abettor for substantially assisting CTI's violations of that disclosure obligation. The court also correctly held that the Commission is authorized to obtain injunctive relief against petitioner for his aiding and abetting violations of the securities laws. Neither ruling conflicts with the decision of any other court of appeals or of this Court. Further review is therefore not warranted.

1. Petitioner contends that there was no underlying violation of the securities laws, and therefore he could not be found liable for aiding and abetting such violations. According to petitioner, there was no underlying violation because the Fifth Amendment privilege against compelled self-incrimination shielded from disclosure the information withheld from CTI's quarterly reports. Petitioner contends that the court of appeals' rejection of that Fifth Amendment defense is inconsistent with *California* v. *Byers*, 402 U.S. 424 (1971), and *United States* v. *Matthews*, 787 F.2d 38 (2d Cir. 1986). Those contentions are erroneous.

a. In *Byers*, the Court held that a California "hit and run" statute that required a driver involved in a car accident to stop and give his name and address to the police did not infringe the driver's privilege against compulsory self-incrimination because the information sought was not generally and inherently incriminating and was required to be disclosed for regulatory purposes. *Byers* thus established that the Fifth Amendment does not shield information from disclosure when the information is required to be disclosed for regulatory purposes rather than for purposes of criminal law investigation, and when the information required is, as a general matter, not inherently indicative of criminal activity. See 402 U.S. at 430-431 (plurality opinion); *id.* at 454-456 (Harlan, J., concurring in the judgment). As the Court explained in *Baltimore City Department of Social Services* v. *Bouknight*, 493 U.S. 549, 556 (1990), "the Fifth Amendment privilege may not be invoked to resist compliance with a regulatory regime constructed to effect the State's public purposes unrelated to the enforcement of its criminal laws."

The Fifth Amendment privilege does not preclude the application of a neutral disclosure requirement merely because that requirement may effectively lead to disclosure to the government of incriminating information *in a particular case.* In *Byers*, the plurality explained that point by reference to the Court's decision in *United States* v. *Sullivan*, 274 U.S. 259 (1927). In *Sullivan*, a bootlegger prosecuted for failure to file an income tax return contended that the Fifth Amendment privilege gave him a complete defense; the bootlegger's tax return would have tended to incriminate him by revealing the unlawful source of his income. Nevertheless, this Court

in *Sullivan* held that the privilege did not apply, for although the compelled filing of a tax return in that case would have tended to incriminate the bootlegger, the questions in the income tax return were neutral on their face and directed to the public at large. See *Byers*, 402 U.S. at 429 (plurality opinion) (discussing *Sullivan*).

In this case, as in *Byers*, information neutral on its face was required to be disclosed for regulatory purposes. The federal securities laws require public companies to file, for the benefit of investors, periodic reports of their business activities. The reports in this case were required to include financial statements. See 15 U.S.C. 78m; SEC Rule 13a-13, 17 C.F.R. 240.13a-13; SEC Form 10-Q. Further, information contained in those reports must be truthful and complete so as not to mislead investors. See 15 U.S.C. 78j(b); SEC Rules 10b-5 and 12b-20, 17 C.F.R. 240.10b-5 and 240.12b-20. The kind of information required to be disclosed is generally neutral, although in this particular situation it might have revealed criminal wrongdoing. Thus, the decision below is fully consistent with *Byers*; indeed, in *Byers*, the lead opinion pointed to the reporting provisions of the federal securities laws as an example of a constitutionally permissible regulatory regime that requires disclosure even though the required information might be incriminating in a particular case. See 402 U.S. at 427-428.

The court of appeals correctly rejected petitioner's Fifth Amendment argument for another reason: CTI, the corporation that was required to file the quarterly reports, had no Fifth Amendment privilege against self-incrimination. Any Fifth Amendment privilege belonged only to Wheeler, the company's

president, not to the company. See *Hale* v. *Henkel*, 201 U.S. 43 (1906). Wheeler, moreover, could not interpose his personal privilege to excuse the company from its obligation to make truthful and complete disclosures under the reporting and antifraud provisions of the securities laws. As the Court made clear in *Braswell* v. *United States*, 487 U.S. 99, 115-116 (1988), a corporate officer may not invoke the Fifth Amendment to bar production of corporate records that might personally incriminate him.

Matthews, the Second Circuit decision on which petitioner relies, is not inconsistent with those Fifth Amendment principles. In *Matthews*, the court held that the defendant could not be convicted of violating Section 14(a) of the Exchange Act, 15 U.S.C. 78n(a), and SEC Rule 14a-9, 17 C.F.R. 240.14a-9, which prohibit false and misleading representations in proxy solicitations. The government's theory in that case was that Matthews, who was a management candidate for director, should have disclosed in the company's proxy statement that he was a member of a conspiracy to bribe state tax officials on matters relating to the corporation, even though at the time he had not even been indicted for that crime (he was in fact later acquitted on that charge). The court emphasized that the SEC's regulations and forms expressly required only that convictions and pending criminal proceedings be disclosed, 787 F.2d at 47, and held that Matthews was not otherwise obligated by the regulations' general provisions prohibiting materially false or misleading proxy statements to accuse himself of participation in a conspiracy as to which no formal charge had been made, *id.* at 46. In this case, by contrast, it is clear that the omission of information from CTI's quarterly reports rendered the

statements that were made in those reports materially misleading. Accordingly, there is no conflict between the decision below and *Matthews*.

2. Petitioner also argues that the court of appeals erred in concluding that the newly enacted Section 20(f) of the Exchange Act authorized the district court's injunction preventing him from engaging in future violations of the Exchange Act. He argues that Section 20(f) should not be applied to his case because, in his view, its application here would violate the presumption against retroactivity of new statutes. That contention is incorrect.

First, the application of Section 20(f) to this case should not be viewed as involving a statute's retroactive application since Section 20(f) did not work a "change" in the law within the meaning of retroactivity analysis. As this Court made clear in *Landgraf* v. *USI Film Products*, 511 U.S. 244, 269-270 & n.23 (1994), legislation is deemed retroactive only when it changes legal rights, duties, disabilities, or consequences. See also *Hughes Aircraft Co.* v. *United States ex rel. Schumer*, No. 95-1340 (June 16, 1997), slip op. 8-10. Section 20(f), however, did not change the law, as reflected in the prevailing judicial decisions, at the time of its enactment with respect to injunctions in favor of the Commission in aiding and abetting cases.

Although petitioner argues that the reasoning of this Court's decision in *Central Bank* precluded Commission actions, in fact, *Central Bank* held only that there is no implied private action for damages under Section 10(b) for aiding and abetting. *Central Bank* did not decide whether the Commission may bring an injunctive action to prevent such aiding and abetting. See *United States* v. *O'Hagan*, No. 96-842

(June 25, 1997), slip op. 20 (emphasizing that *Central Bank* "concerned only private civil litigation under § 10(b) and Rule 10b-5" and was based on policy concerns about the implied private civil action available under Rule 10b-5). When Section 20(f) was enacted, the pre-*Central Bank* case law holding that the Commission could bring enforcement actions against aiders and abettors remained in effect in the Ninth Circuit, where this case arose, and had not been significantly questioned in the lower courts.[2]

The fact that Congress, in enacting new Section 20(f), eliminated doubt as to the Commission's authority to bring an enforcement action based on aiding and abetting does not mean that Section 20(f) changed the law, within the meaning of the Court's analysis of retroactivity in *Landgraf*. The possibility that this Court's reasoning in a decision might be extended, as petitioner urges with respect to *Central Bank*, to a set of cases not yet covered by the decision's holding is not the same thing as establishing the law on a given subject. Neither this Court nor any court of appeals has ever held that *Central Bank* precluded Commission actions for aiding and abetting. Nor does

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[2] See *SEC* v. *Arthur Young & Co*, 590 F.2d 785 (9th Cir. 1979) (aiding and abetting violation of Section 15(d)); see also *SEC* v. *Falstaff Brewing Corp.*, 629 F.2d 62 (D.C. Cir.), cert. denied, 449 U.S. 1012 (1980); *SEC* v. *Coven*, 581 F.2d 1020 (2d Cir. 1978), cert. denied, 440 U.S. 950 (1979); *SEC* v. *Coffey*, 493 F.2d 1304 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975); *SEC* v. *International Chem. Dev. Corp.*, 469 F.2d 20 (10th Cir. 1972); *SEC* v. *Barraco*, 438 F.2d 97 (10th Cir. 1971). At the time that Section 20(f) was enacted (and even now), only one district judge had extended *Central Bank* to a Commission enforcement action. *SEC* v. *United States Envtl., Inc.*, 897 F. Supp. 117, 119-121 (S.D.N.Y. 1995).

that question, which the court of appeals never reached, now warrant this Court's review, given the enactment of Section 20(f) to preserve the existing understanding of the law and prevent the extension of *Central Bank* to Commission cases.

As neither *Central Bank* nor Section 20(f) changed the law with respect to Commission actions, it is apparent that *Rivers* v. *Roadway Express, Inc.*, 511 U.S. 298 (1994), relied upon by petitioner, has no bearing on this case. In *Rivers*, the Court applied the presumption against retroactivity to a provision of the Civil Rights Act of 1991 that overturned *Patterson* v. *McLean Credit Union*, 491 U.S. 164 (1989) (which, in turn, had disapproved extensive court of appeals authority to the contrary) and returned the law to its state in most of the courts of appeals before the *Patterson* decision definitively interpreted the relevant statutory provision, 42 U.S.C. 1981. The Court noted in *Rivers* that Congress had *not*, in the Civil Rights Act of 1991, described the effect of its new provision as restoring prior law, but had described it rather as expanding the scope of prior civil rights legislation. 511 U.S. at 308. In the present case, the legislation at issue was enacted before there was any change in the law, in order to confirm the law as it existed. Similarly, *Plaut* v. *Spendthrift Farm, Inc.*, 514 U.S. 211 (1995), also relied upon by petitioner, concerned Congress's attempt to change previous law with respect to the statute of limitations in private securities actions. Here, by contrast, the legislation at issue did not change the law.

Second, even if Section 20(f) might be said to have changed the law, that Section nonetheless does not implicate the presumption against retroactivity in

this case, because the remedy entered here, an injunction against future wrongdoing, is forward-looking. Such injunctions do not attempt to right wrongs already done by restoring one or both parties to an earlier position. Instead, injunctions such as the one at issue here operate on future conduct to prevent future harm. The reason for examining past misconduct in this case was not to assess and remedy the harm already caused; rather it was to evaluate whether the defendant was likely to engage in violations in the future unless enjoined. Thus, the fairness and due process concerns that underlie retroactivity analysis do not arise in the context of an injunctive action, in which the defendant is told what conduct is prohibited and given a chance to conform his conduct to the law in the future.

In recognition of the different character of injunctions and similar remedies, the Court in *Landgraf* distinguished prospective forms of relief from backward-looking remedies like damages. 511 U.S. at 285 n.37. In *Landgraf* the Court explained that, when a new statute authorizes or affects the propriety of prospective relief, it may be applied in pending cases without having retroactive effect, because "relief by injunction operates *in futuro*." *Id.* at 274. Thus, in accordance with *Landgraf*, the authorization of Commission injunctive actions in Section 20(f) may be applied to this pending case.

Finally, even if Section 20(f) might be said to have changed the law, it is nonetheless reasonable to conclude that Congress intended the new legislation to apply to all Commission cases, and not just to those involving post-enactment conduct. It would be inconsistent with the purpose of the legislation for Congress to have meant for *Central Bank* to be

extended to pre-enactment conduct, thereby creating a gap in the otherwise consistent law that the Commission can bring injunctive actions for aiding and abetting. It is more sensible to construe the legislation as applying the same law to all defendants, which would give full effect to Congress's decision that sound public policy requires that the Commission be able to enjoin aiders and abettors. In any event, the holding below that injunctive relief was proper in this case under Section 20(f) presents no issue of continuing importance warranting review by this Court.

3. Petitioner complains that the court of appeals "departed from the accepted and usual course of judicial proceedings" by ruling *sua sponte* that Section 20(f) applies to this case, without affording him an opportunity to brief or argue the question of retroactivity. Pet. 12. Petitioner asserts that he was entitled to oral argument on that issue under Federal Rule of Appellate Procedure 34. This case was orally argued, however, and Rule 34 nowhere suggests that another oral argument is required whenever a new issue arises. Further, nothing inhibits a court from determining for itself the controlling law. See *United States Nat'l Bank of Oregon* v. *Independent Ins. Agents of America, Inc.*, 508 U.S. 439, 446 (1993).[3] In any event, petitioner availed himself of the opportunity to brief the retroactivity issue in his petition to

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[3] This Court has itself had occasion to raise and decide an issue of retroactivity without briefing or argument on the issue. In *Allen* v. *Hardy*, 478 U.S. 255 (1986), the Court decided *sua sponte* that *Batson* v. *Kentucky*, 476 U.S. 79 (1986), should not be applied retroactively to cases pending on collateral review, even though neither party nor any lower court had addressed the issue.

the court of appeals for rehearing. Thus, he was not precluded from presenting his arguments concerning the issue to the court of appeals. [4]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[4] Petitioner asserts that the new legislation changed the standard for scienter in connection with aiding and abetting claims to "knowingly" providing substantial assistance, and he urges that the case be remanded to the district court for findings on his knowledge. Pet. 12. Remand is unnecessary, however, for the district court has already expressly found that petitioner had actual knowledge of the wrong that he assisted in carrying out. Pet. App. 18c.